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May 1, 2000

Magalie Roman Salas, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

ORIGINAL

Re: Reply Comments Of The National Association Of State Utility Consumer Advocates
CC Docket No. 98-137, CC Docket No. 99-117 and AAD File No. 98-26

Dear Ms. Salas:

We now understand that NASUCA could not make an electronic filing in this proceeding. We filed electronically on Friday, in the above-referenced CCB Docket Nos. Please accept these Reply Comments Of The National Association Of State Utility Consumer Advocates for filing in AAD File No. 98-26.

Sincerely,

Michael J. Travieso /sad.

Michael J. Travieso
People's Counsel

MJT/mcm

Enclosure

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of

1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers	)	CC Docket No. 98-137
Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, *et. al.*	)	CC Docket No. 99-117
GTE Telephone Operating Companies Release of Information Obtained During Joint Audit	)	AAD File No. 98-26

REPLY COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

I. BACKGROUND

The National Association of State Utility Consumer Advocates files these Reply Comments to address the Comments of various parties filed in response to the Commission's Further Notice of Proposed Rulemaking of April 3 in the above-captioned proceedings. NASUCA is an association of 42 consumer advocate offices in 39 States and the District of Columbia. NASUCA members, for the most part by virtue of the laws of their respective states, represent the interests of utility consumers before state and federal regulators and in the courts. NASUCA member agencies generally focus their representation on the interests of millions of residential and small business consumers throughout the United States. NASUCA is a frequent commentor in Commission

proceedings and has been an active opponent of the various CALLS proposals of which this is one.[1]

The Further Notice of Proposed Rulemaking (FNPRM) sought comments on a proposal filed by the ILEC members of CALLS[2] to obtain a waiver of the Commission's depreciation requirements. The ILEC members have asserted that their proposal "to eliminate the disparity that exists between the regulatory and financial accounting of depreciation expense and associated reserve balances" over the five-year life of the CALLS plan "offer[s] the same protections sought by the Commission in the Depreciation Order." Comments of Bell South, at 3. See also: Comments of SBC, at 4; Comments of Bell Atlantic, at 3 ("above the line treatment cannot affect interstate rates"). Because the ILEC members of CALLS represent almost the entire class of carriers subject to the Commission's depreciation rules, the Commission issued its FNPRM "to evaluate the conditions under which our existing depreciation rules may be eliminated or changed for all price-cap carriers." (FNPRM, ¶3).

[1] NASUCA has submitted Comments, Reply Comments, Supplemental Comments and Supplemental Reply Comments in the proceeding begun by the Commission in the Notice of Proposed Rulemaking released on September 15, 1999 in CC Docket No.'s 96-262; 94-1; 99-249; 96-45. NASUCA's comments in that proceeding demonstrate that the Coalition for Affordable Local and Long-Distance Service (CALLS) proposal is an anti-consumer, anti-competition plan hatched by some of the largest telecommunication companies in the world to insulate revenue streams and profits from competition and to shift costs which should be borne by these companies onto the backs of local phone service customers in the form of fixed surcharges.

[2] Bell Atlantic, Bell South, SBC and GTE.

II. STATEMENT OF NASUCA POSITIONS

1. The Process Is Defective

NASUCA agrees with that part of the Statement of Commissioner Harold Furchtgott-Roth that is critical of the process invoked by the Common Carrier Bureau in attempting to gain support for the CALLS proposal from certain, but by no means all, of the parties with interests in the access reform and universal service proceedings. This process has eroded the Bureau's ability to analyze this depreciation waiver proposal with any degree of objectivity.

According to Commissioner Furchtgott-Roth, the Bureau has already "agreed to recommend to the Commission that it approve the waiver that is the subject of this Notice and terminate the CPR audits." This agreement is part of a larger agreement by the Bureau to broker a deal between AT&T and certain price cap ILECs which would require the Commission to approve, without modification and in its entirety, the entire CALLS proposal. This process greatly compromises the impartial role that the Commission must play and could unfairly and illegally terminate the rights of consumers and competitors to obtain a fair review by the Commission of the many issues now pending in seven different proceedings.[3]

2. This Waiver Should Not Be Granted Because It Would Constitute, In Effect, The Approval Of An Inducement To The CALLS ILEC Members For Their Support Of Access Reductions

As noted above, NASUCA has filed four sets of comments opposing the CALLS scheme in its entirety. We incorporate those objections here. The CALLS members are

[3] CC Docket Nos. 96-262; 94-1; 99-249; 96-45; 98-137; 99-117 and AAD File NO. 98-26.

attempting to dictate a pre-ordained result through the CALLS proposal. The Comments of Bell Atlantic demonstrate this:

> Bell Atlantic's support [for the depreciation waiver proposal] is contingent on an adoption of the CALLS proposal. Just as Bell Atlantic's support of the CALLS proposal is itself contingent on the adoption of the CALLS proposal as a whole, Bell Atlantic's support for the Commission's depreciation proposal is contingent on the adoption of the entire CALLS package. As it did in its earlier depreciation forbearance order, the Commission should make this new alternative an option that can be exercised at a carrier's discretion.

It is truly a sad state of affairs when the regulated believe they ought to be able to dictate terms to the regulators. NASUCA is confident that the Commission will continue to regulate these carriers, not the other way around. NASUCA urges the Commission to reject this particular proposal, not only because it harms consumers, is not in the public interest and does not comply with the Commission's Depreciation Order, as will be shown below, but also because it is conditioned on Commission approval of unrelated proposals which do not have broad support from competitors and consumers and are themselves not in the public interest.

NASUCA agrees with the Comments of the Ad Hoc Telecommunications Users Committee:

> ...the ILEC depreciation proposal should be severed procedurally from the Commission's consideration of the CALLS proposal and carefully weighed on its own merits according to the framework laid out in the Depreciation Order.
>
> The CALLS proposal for universal service and interstate access charge reform raises entirely separate matters from the issues raised in the depreciation waiver request. Moreover, given the highly negotiated process by which

> the Commission has considered the CALLS proposal, a process that has apparently excluded some of the participants in that docket, it would be entirely at odds with the public interest for the Commission to allow the ILECs to join these two unrelated proceedings at the eleventh hour and, in one fell swoop, compromise the integrity of CC Docket 98-137 and end run the Commission's thoughtfully deliberated framework and open process for considering ILEC depreciation waivers. (Ad Hoc Comments, at 4, 5).[4]

See also: MCI Worldcom Comments, at 7, 8 "[F]or the Commission to grant the ILECs near-complete freedom from depreciation regulation and absolve the ILECs from any consequences from their massive and ongoing violations of the Commission's CPR rules is far too high a price to pay for the modified CALLS plan."

Given the strong opposition to the CALLS plan, particularly from consumer groups, accepting an "all or nothing" proposal from a few regulated companies in order to close numerous unrelated dockets would establish a bad Commission precedent.

3. The Calls Depreciation Waiver Proposal Is Not Consistent With The Depreciation Order And Would Harm Consumers

As many Commentors have noted, the Commission has established four necessary but not necessarily sufficient conditions which could permit a waiver to be approved: (1) a below-the-line write-off of the difference between the net book costs on the regulatory books from the level reflected on the financial books; (2) use of the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) a commitment

[4] NASUCA attempted to insert itself into these discussion in order to protect the interests of state consumers. NASUCA never supported any of the CALLS proposals and consistently took the position that the ILEC's are overearning by huge amounts and that access reform does not requires that ILEC revenues be held harmless through increases in the SLC. NASUCA urges the Commission to recognize the huge overearning positions of all of these ILEC's (earned returns of between 14% and 29% against a cost-of-capital of 9.3%) and reduce ILEC revenue not only from IXC's, but also from consumers by reducing the SLC. (See: Comments of the GSA, at 6 and the NARUC on ILEC overearnings.)

not to seek recovery of the write-off through a low-end or exogenous adjustment or an above cap filing; (4) a commitment to submit certain information concerning depreciation accounts.[5] The Commission also said that it would "consider" alternative proposals if such proposals provide "the same protections to guard against adverse impacts on consumers and competition as the conditions adopted in [the] Order..." *Id.*

a. An Above-The-Line Five-Year Amortization Plan Does Not Provide The Same Protection As A One-Year Below-The-Line Write Off

The ILECs' propose an above- the-line write off with a five-year amortization of the difference between net book values plus a commitment not to seek interstate recovery of the amortization during the five-year period. The FNPRM sought comment on whether these commitments, including what it must have believed was a commitment by the ILECs not to seek any state rate increases for the amortization expense, would adequately protect consumers from adverse rate impacts and would otherwise meet the policy goals of the Depreciation Order.

The ILECs have uniformly commented that they are making no commitments regarding state rates and that the Commission lacks the authority to seek such a commitment, even a voluntary one.[6]

The ILECs own comments demonstrate the adverse impact that their above-the-line proposal will have on consumers. First, they will be free to seek similar write downs on their state regulatory books and recovery in state rates of the amortization expense.

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[5] Depreciation Order, ¶25, at 11,12.

[6] Comments of SBC, at 11, 12; Comments of Bell Atlantic; at 3,4; Comments of Bell South, at 4, fn. 5.

The assets they are writing down are not "federal only" assets. For cost-of-service states these ILECs would claim these 28 billion dollars of increased depreciation expenses in rate cases. ILECs who are under state price cap plans would claim that these new expenses come about as a result of "regulatory actions" or "accounting changes" and are therefore recoverable under the exogenous change provisions of those plans. NASUCA agrees with MCI that the "proposed amortization would give the ILECs a powerful new argument in favor of increasing state rates,[7] and the Commission has given the states almost no opportunity – only two weeks – to comment of this matter." MCI Comments, at 13.[8]

However, the potential of harm to customers through state rate increases is not the only potential harm to consumers.

NASUCA agrees with the numerous commentors who have detailed the potential this plan has for harming consumers:

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[7] The National Association of Regulatory Utility Commissioners (NARUC) has commented that "an above-the-line adjustment will artificially lower the reported earnings of the carriers which will critically distort decision making on policy issues both at state and federal levels. Further, an above-the-line adjustment could infer (sic) that the carriers' financial depreciation rates are reasonable for regulatory purposes." See also: Comments of the Indiana Utility Regulatory Commission opposing the waiver, at 5.

[8] NARUC felt strongly enough about this very short comment period to take the FCC to task, "[S]tate commissioners which hold publicly noticed meetings can barely react in such a brief amount of time." Although NARUC claims that the CALLS depreciation waiver proposal can be acceptable with only "minor" adjustments, these adjustments would change the proposal in its entirety. NARUC proposes a one-year below-the-line write-off to prevent artificially low earnings; no federal or state rate impacts; the rejection of the use of shorter equipment lives; the continued oversight by the FCC of depreciation where it is a significant portion of the cost or price; oversight where GAAP depreciation other than straight line is used; a separate showing where depreciation expenses trigger a low-end adjustment; a quantification of the overall change that will result from moving to financial depreciation rates; financial depreciation information related to 1999 and projected for 2000; a requirement that the ILEC's be required to submit the same information they must submit for a waiver under the Depreciation Order; no change regarding the confidentiality of data and no termination of the CPR audit because it is in the public interest to resolve the questions raised in that proceeding about phantom assets and bad accounting practices because of the impact of these issues on the funding of universal services and the overstatement of depreciation expense. While NASUCA urges the rejection of the CALLS depreciation waiver request, if the Commission will consider it, it should, at a minimum, accept the NARUC "minor" modifications.

1. The ILECs commitments only relate to the amortization expense. They will surely seek to flow through their higher depreciation expenses in both the federal and state jurisdictions. Seventy five percent of these expenses would be allocated to the states for ratemaking purposes. (GSA Comments, at 12). According to the Commission's own staff, allowing the incumbent price cap LEC's to use the shorter lives they intend to use could increase their depreciation expense by 50%. The Staff has determined that this large increase in depreciation expense would provide all of these carriers with an opportunity to seek a low-end adjustment. Depreciation Order, at 14, fn. 86. The CALLS ILEC's have not promised to forego low-end adjustments related to depreciation expense, as opposed to the amortization expense.

2. Using a five-year above-the-line write off will allow these ILECs to engage in a practice specifically recognized in the Depreciation Order, ¶26, as disadvantaging consumers and competition by allowing the ILECs to use high financial depreciation rates with high regulatory net book costs during this five-year period. This would have the effect of artificially increasing the ILECs revenue requirements by not reducing immediately the size of the regulatory rate base through an immediate write-off. (MCI Comments, at 16, 17; GSA Comments, at 5 (artificially lower rate-of-return.))

3. The ILECs have only committed not to seek rate adjustments directly caused by the amortization expense. Furthermore, they have sought above-the-line treatment for the express purpose of depressing their regulated earnings and rates of return. Bell Atlantic Comments, at 2 ("the amortization expense should be included for purposes of determining reported regulatory earnings"); SBC Comments, 6-8; Bell South Comments, at 8. "[M]aking this adjustment below the line... would artificially inflate earnings."

The combination of earnings reduced by billions of dollars each year and the artificially high rate

base and revenue requirement and the huge increase in depreciation expense[9] could easily lead to requests for rate increases in both the federal and state jurisdictions without regard to the amortization expense itself.

4. The use of higher financial depreciation rates, in and of themselves, in the future would also increase high cost support drawn from the universal service fund; increase interconnection and UNE rates and increase costs charged to competitors by these ILEC's for pole and conduit attachments. Ad Hoc Comments, at 12.

5. The use of higher financial depreciation rates will directly impact on the proceedings which the Commission intends to have to support its decision to raise the SLC. Higher financial depreciation expenses would increase loop costs despite the fact that in December 1999 the Commission found that the use of shorter lives, expect for digital switches, and GAAP accounting was not in the public interest. Depreciation Order, ¶'s 13, 14, 16, 17, 48, 50.

6. The proposal only applies during a five-year period. Nothing will prevent these ILECs from seeking recovery for these above-the-line write-offs after the five-year period expires.

NASUCA urges the Commission to recognize that the CALLS waiver proposal, as explicated by the Comments filed by the ILEC CALLS members, is merely an attempt to relitigate positions already rejected just a few months ago in the Depreciation Order. The above-the-line aspect of this proposal coupled with the ILECs' vague and unenforceable promise to make a "submission of information concerning depreciation accounts when significant changes to depreciation factors are made" (read, when it is in their advantage to do so) completely eviscerate the public policy and consumer protection

[9] Depreciation expense is the largest ILEC expense. It represents nearly 30% of ILECs' operating expenses. Depreciation Order, at 17, 37.

goals enunciated in the Depreciation Order. The facts and the law have not changed since December 17, 1999. The only change is that the CALLS members are engaged in effort to persuade the Commission to reverse itself on depreciation waivers by dangling in front of the Commission the prospect of wrapping up a number of troubling dockets at once. Expediency cannot substitute for public policy and the requirements of law.

NASUCA believes that the following conclusions from the Depreciation Order are total and complete answers to the Comments of the ILEC CALLS members. They seek to equate a five-year above-the-line amortization with an immediate below-the-line write-off; attempt to virtually eliminate all record keeping and filing requirements; and seek the termination of the CPR audit which found that they are carrying $5.2 billion of assets on their books which they cannot find.

The Commission cannot square an approval of the CALLS ILEC members' proposal with the following conclusions from the Depreciation Order. We have omitted the footnotes from these paragraphs:

28. These first three conditions are imposed in order to guard against adverse impacts consumers and competition. Without these conditions, the largest incumbent LECs could use their high financial depreciation rates with their high regulatory net book costs, thereby drastically increasing their annual depreciation expenses. Large increases in depreciation expenses on the carrier's regulatory books would significantly reduce carrier's earnings, which in the case of most all the largest incumbent LECs, would be of such magnitude as to lower rates of return below 10.25%. This in turn could trigger a low-end adjustment, or could lead to carriers seeking recovery through exogenous cost treatment or above-cap filings. These recovery mechanisms, if granted , could enable incumbent LECs to increase prices they charge for access services and in rates they charge for unbundled network elements (UNEs) and interconnection. Increases in access services prices, which could be substantial, would be imposed on purchasers of access and passed on to their customers. The harmful impact that increased charges could have on competition is also substantial. State regulatory commissions have set rates for interconnection and UNEs and in many instances, have based the rates on Commission-prescribed depreciation factors. Incumbent LECs, acting as wholesale providers of

critical facilities to their competitors, could independently establish depreciation rates that could result in unreasonable high interconnection and UNE rates, which competitors would be compelled to pay in order to provide competing local exchange service.

29. ...Our current depreciation prescription process is critical in the calculation of high cost support amounts... because it ensures that the depreciation expense component of the carriers' average costs per loop are reasonable. If we were to allow incumbent LECs to choose their own depreciation factors without review, we could no longer ensure that the depreciation expense or the average cost per loop were reasonable. If these carriers were to use their financial depreciation factors for regulatory purposes, they would report major increases in their average costs per loop. ...Under this method, however, because high cost support is subject to a cap, increases in the largest incumbent LECs' high cost support would not increase the fund. Instead, it would lead to substantial reductions in the high cost support for other, primarily rural, carriers, many of which rely to a great extent on high cost support to keep their local rates affordable.

30. In light of the significantly harmful impact that unrestricted changes in depreciation expenses could have on consumers and competition, we find the public interest is protected only if safeguards are in place that will negate such potential harm. We believe the first three conditions provide the appropriate safeguards and will ensure that carriers do not unreasonable increase depreciation expenses as a result of granting flexibility to establish their own depreciation rates.

31. The fourth condition requires that carriers who obtain a waiver of our depreciation process submit certain information about network retirement patterns and modernization plans related to their plant accounts so that we can maintain realistic ranges of depreciable life and salvage factors for each of the major plant accounts. This condition seeks to ensure that the Commission has the necessary data to periodically update depreciation factors (*i.e.,* life, salvage, curve shape, depreciation reserve) and to address issues in areas where reliance on the carriers' financial depreciation rates may be inconsistent with other regulatory policy goals. Maintaining appropriate depreciation ranges for the major plant accounts will continue to be critical even though some carriers may be granted relief from the Commission's prescribed depreciation process. This is especially true given the Commission's reliance on the prescribed depreciation ranges in the use of its cost models for universal service high cost support and UNE/interconnection prices.

33. ...We are concerned that forbearance from depreciation regulation by the Commission might deprive state regulatory commissions of valuable information that they may want or need in setting rates for interconnection and UNEs and might enable incumbent LECs to raise arbitrarily the rates for essential inputs that competitors must purchase from the incumbent LECs. This could have an adverse impact on the development of local competition.

35. ...The four conditions outlined above are intended to mitigate our concerns about the adverse impacts that could occur when carriers are given the freedom to select their own depreciation lives and procedures.

39. ... As stated earlier, we fully intend to maintain realistic ranges of depreciable life and salvage factors for each of the major plant accounts. Thus, even if we waive the depreciation prescription rules for certain carriers, we will be able to ensure realistic depreciation factors by determining whether the life estimates underlying their cost support are within the prescribed depreciation ranges.

43. ...As discussed below, we find that unrestricted changes in depreciation practices could prevent us from ensuring that increases in carriers' rates are just and reasonable. Thus, we find that our depreciation prescription process is necessary to ensure just and reasonable charges.

47. ...If we were to forbear from all depreciation regulation, incumbent LECs would have both the ability and the incentive to trigger the low-end adjustment by establishing new, shorter depreciation projection lives that would allow the carrier to record larger depreciation expenses in any particular accounting period. ...Without such oversight, the Commission would have little or no basis on which to evaluate the reasonableness of the incumbent LECs' claimed depreciation. Since depreciation expense is an incumbent LECs largest single cost, inflated claims for depreciation expense could result in increased rates and could hamper our ability to ensure just and reasonable rates.

48. ... An incumbent LEC using GAAP would have substantial latitude to select different methods of depreciation, such as accelerated depreciation that could significantly alter the depreciation expense that the LEC could claim. ...We are not persuaded that the role of the conservatism principle in GAAP has changed or that we should change our previous decision. ...We believe that giving incumbent LECs the right to select, for regulatory purposes, any depreciation rate allowed by GAAP is inappropriate as long as incumbent LECs reserve the right to make claims for regulatory relief based on the increased depreciation that would result from granting them that flexibility.

54. ...We conclude that USTA has not demonstrated that the local exchange market is sufficiently competitive to make depreciation prescription unnecessary.

59. ...Forbearance of the depreciation prescription process could potentially trigger large increases in a carrier's depreciation expenses, which could in turn result in unwarranted increases in consumer rates. These increased depreciation expenses and consumer rates would likely to continue for many years until robust competition curtains the ability of the incumbent LECs to secure these rates from consumers.

60. ... If the largest incumbent LECs used shorter depreciation lives, thus increasing their depreciation expense, they would report significant increases in their average costs per loop... .

63. ... Specifically, we find that forbearance would be likely to raise prices for interconnection and UNEs (particularly those that may constitute bottleneck facilities) inputs competitors must purchase from incumbent LECs in order to provide competitive local exchange service. Because we find that the result of forbearance would be higher costs for competitive LECs which could impair their ability to enter and compete in local markets, we cannot find that forbearance would promote competitive market conditions.

68. ...We find that forbearance would not enhance but, rather, would likely retard competition. Because the primary purpose of requiring incumbent LECs to provide interconnection and unbundled network elements is to stimulate competition in the provision of local exchange service, allowing ILECs to increase rates for those services by significantly increasing depreciation expense could adversely affect competition by raising input prices that competitors pay.

69. ...Based on our review to date, twenty-four states commissions have required incumbent LECs to use FCC-prescribed projection lives and salvage factors, or similar state-prescribed factors, to calculate their rates for UNEs. We are concerned that forbearance from depreciation regulation by the Commission might deprive state regulatory commissions of valuable information that they may want or need in setting rates for interconnection and UNEs, and might enable incumbent LECs to raise arbitrarily the rates for essential inputs that competitors must purchase from the incumbent LECs. This could have an adverse impact on the development of local competition.

71. ...Consequently, we conclude that, with respect to interconnection and UNEs, forbearance from depreciation prescription is not in the public interest because it is likely to have an adverse effect on competition by raising the input prices that competitors must pay to provide local exchange service.

Nothing has changed since the Commission reached these conclusions in December of 1999. The ILECs have not presented any evidence or argument which could possibly change the Commission's position. Their promise not to seek federal recovery of the amortization expense does not at all address the concerns of the Commission stated in the preceding paragraphs from the Depreciation Order.

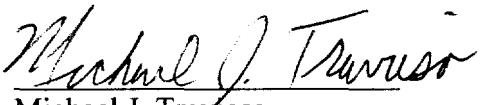
b. The CPR Audits Should Not Be Terminated And Are Not Moot

Finally, NASUCA agrees with those commentors who press upon the Commission that the CPR audit proceedings should not be terminated and are not rendered moot. See Comments of MCI, at 21; Indiana Utility Regulatory Commission, at 5, 6; Ad Hoc Committee, at section B; GSA, at 9-12; and NARUC. There is $5.2 billion in assets at issue. The depreciation expense and the return on these phantom assets is worth a lot of money to the ratepayers. Furthermore, the accounting practices which lead to this situation must be corrected.

III. CONCLUSION

NASUCA urges the Commission simply to reject the ILECs' petition for forbearance. These ILECs' have made no showing that the relief they seek is in the public interest.

Respectfully submitted,



Michael J. Travieso
Chair
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On Behalf Of NASUCA

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